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RE: A Delaware recession?

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What will be the impact of the Covid-19 virus on Delaware's economy?

There are two extreme views among economists regarding the U.S. economy. The first view anticipates a substantial recession similar to 2008-09. The second expects a severe dip in the second quarter of 2020 with a steady rebound thereafter.

I favor the severe dip scenario. The 2008-09 recession was prolonged because there were extreme price distortions in residential and capital markets that took time to correct. The wealth effect from stock market losses was compounded by a huge decline in residential housing equity.

The Covid-19 crisis, while painful to many families, will have a temporary sharp impact on the U.S. macro economy. The pandemic measures adopted will fall the most heavily on restaurants, hotels, and the airlines. The wealth effect from the losses in the stock market will retard consumer spending in the short term, but the underlying prices and resource markets in the nation are sound and two consecutive quarters of declining GDP is unlikely.

How hard was Delaware hit by the 2008-09 recession? Employment dropped by 50,000 over a period of 20 months…an 11% decline. Total wages and personal income declined for a year with losses of 3% to 4%. And output fell 6% over five quarters.

The structural changes in Delaware's economy precipitated by the 2008-09 recession were profound. As happened following the 1973-75 recession, the 2008-09 recession dramatically altered Delaware's manufacturing. Over three and a half billion dollars of annual output was lost from the downsizing of the DuPont Company and Astra Zeneca and the remaining automobile manufacturing, together with the associated wholesale operations.

It took six years for total Delaware employment to recover to its 2008 peak level. And the state's economy is still struggling.

For five months now, based upon its leading economic index for Delaware, the Philadelphia Fed has been forecasting a second quarter 2020 contraction in Delaware's economy. Over the most recent 12 months Delaware employment has increased at a rate of only 0.8% and the unemployment rate has risen to 4%. Half of the jobs added to the Delaware economy over the last four years paid less than $20 per hour.

Two things are clear about the Covid-19 contraction.

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First, like the 2008-09 recession, the Covid-19 contraction will have its greatest impact on workers with less formal education. Workers in hourly wage service job as opposed to salaried college graduates in white collar occupations.

This will put a strain on state social services, especially Medicaid, SNAP, and unemployment insurance.

Second, as Delaware state social service spending increases, state General Fund revenues will struggle. During 2008-09 Delaware state revenues dropped by more than -6%. Currently, as of their March meeting, DEFAC assumes its FY20 increase in total state revenues of 3.2% (over FY19) to remain unchanged and for total revenues to essentially remain stable through FY21. This is optimistic.

As a state task force research has confirmed, Delaware's major taxes are quite sensitive to changes in the business cycle. This includes the state personal income tax, corporate income tax, gross receipts tax, and real estate transfer tax. Even the revenue from the abandoned property tax fell off in 2008-09.

The personal income for 2019 is on the books, but personal income will dip in 2020 which means less personal income tax revenue in FY21 due to slower growth in wages and dividend income. Certainly, between March and June 30th of this year corporate income, gross receipts, and real estate taxes will dip.

On the expense side, in addition to increased demand for social services, the loss in asset earnings for the state pension fund will create a huge gap that must be covered by withdrawals from the General Fund.

The bad news is counter-balanced by a state government operating cash balance of $427 million. This is a combination of the standard rainy day fund and the Governor's new budget stabilization fund.

The dark days of 2008-09 will not reoccur, but over the next year belts will be tightened as a recovery is taking hold.

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